HOWEVER YOU SLICE IT BUYING ENERGY IS UNIQUE

A whitepaper by Summit Energy, a leading energy management firm headquartered in Louisville, KY, USA, with offices in Belgium, France, Mexico, the Netherlands and the United Kingdom.

SummitEnergy

INTRODUCTION

Purchasing professionals face some universal issues, whether they are buying cardboard, beef or industrial exhaust systems. Everyone wants the lowest possible cost. No one wants surprises in the contract. And everyone knows that more bidders typically bring more competitive pricing.

The goals of energy procurement are no different. However, the path to success leads through drastically different territory. Prices change fast and frequently, varying by geographic region and even time of day. Cost is important, but so is predictability. There is not always a price advantage for large purchases. Few commodities can match the complexities of issues impacting this significant expenditure.

According to Purchasing magazine, “Buying energy is like buying any other commodity – except it’s different.”

If you are beginning to think energy and other commodities might be as different as apples and oranges, keep reading. You just might decide they have even less in common. While we can’t cover all the differences, here are five key ones:

1. **Geography matters**
2. **Volatile pricing and tight timing**
3. **Necessity of market intelligence**
4. **Not just aggregation**
5. **Measures of success**

This paper explores these key issues with experienced professionals who manage the energy spend for their corporations. The consensus: Knowledge of these distinct differences empowers you to take the most effective approach to energy management.

1

GEOGRAPHY MATTERS

Whether you're big or small, it's a local game

Unlike other commodities, a facility's location plays a major role in determining how it can buy energy. Typically, in a regulated market buyers must purchase energy from a single supplier, the utility. In a deregulated market, suppliers compete for business. There are countless variations, however. Just because a market is "deregulated" doesn't mean it's "unregulated" – there still will be some market rules. Some types of energy, like electricity, may be regulated in a market, but others, such as natural gas, may be deregulated in the same market. These variations make a single approach to buying for multiple markets completely impractical.

"You don't manage energy in Florida the same way you do in the Northeast," said Kristen Brooks, Vice President of Procurement for OSI Restaurant Partners, which operates Outback Steakhouse restaurants among others. "We can deliver potatoes to all restaurants in the country the same way. You can't do that with energy."

Walt Taylor, director of energy for Wendy's/Arby's Group, couldn't agree more. He has seen some markets with different energy regulations within the same county.

"It's difficult to figure out what's going on," he said. "I could have restaurants literally across the street from each other, and I can't do with one what I can do with the other."

In the industrial sector, Dave Andres sees the same thing from his position as Global Energy and Precious Metals Leader at Owens Corning. His company chose to hire an outside firm to manage its energy spend.

"There's a central infrastructure, but each country or region is different. You have to know who the suppliers are, the generators, taxes, rate plans, regulations ... it all varies by state. With the multitude of states and countries we're in, it's literally impossible for us to maintain that level of expertise."

Brooks added that, since moving into her OSI purchasing position in 2004, she has had some surprise lessons about the geographic nuances of energy buying. "You have to know why the Northeast is tied into natural gas pricing for power," she said. "Now I understand that when there's not enough melting snow in Canada, it can affect pricing."

2 VOLATILE PRICING AND TIGHT TIMING

Huge swings and short deadlines

Energy prices can resemble the stock market. Prices are prone to swing, and companies can seize opportunities only if they act quickly to buy within a relatively short timeframe. "The market prices change a lot more rapidly than for other commodities," said Jay Lutz, Energy Manager for Hormel. "Prices for metals always change, but suppliers don't give you a price and say, 'We need to order this in two days or the price changes.' With energy, it's an hour-to-hour thing." In fact, in many cases, energy prices can be good for just a few hours.

Having a strategic plan helps companies make informed, quick decisions on a short-term offer. Lutz said Hormel has streamlined its contract approval process so they can react quickly when a good opportunity arises.

David Bush, Chief Executive Officer of Iasta, a supply-management solutions firm, said this volatility makes energy buying uniquely complicated. "It's in the top 10 percent of the most complex categories, along with telecommunications, insurance and prescription benefits," he said. "The longer into the future you buy, the greater the risk. Prices could go down. You must treat it market by market."

Glenn Poole, Manufacturing Support Manager for Energy at Verso Paper, said energy costs can change dramatically in any direction, often for reasons outside of anyone's control.

"Our energy costs have dropped by two-thirds in the last year, but that doesn't mean we're doing a great job," he said, noting that market prices have dropped as the economy has slowed. "You do the best you can, considering the market."

Andres at Owens Corning said pricing is further complicated by local practices, some that offer savings and some that cause frustration. He cited a plant in Texas that participates in a demand-response program requiring careful management. The plant can reduce costs if they agree to lower demand during peak hours, but the plant gets just 10 minutes notice. In another case, for six months, several Ohio plants didn't know what their power costs were going to be because the state was engaged in regulatory shifts.

"That's just chaos," he said.

NECESSITY OF MARKET INTELLIGENCE

It's hard to know what you need to know

Verso's Poole said in large companies, energy is a specialized area of purchasing because it requires so much market knowledge and constant monitoring. "When buying standard components, if you want one or 50, you set some specs and it's a little more straightforward," he explained. "In most cases, it's not regulated. No one is making the market and setting the market rules. But with energy, there is a lot of moving parts."

Verso uses an outside source for market intelligence, and Poole spends much of his time working to impact the agenda of legislative and regulatory bodies. "Many end-users of energy don't realize their leverage," he said.

Andres with Owens Corning, another large manufacturer, also has been active in public policy issues. He agreed that major corporations typically put senior personnel in charge of energy buying. Owens Corning uses an outside company to manage its energy buy, in large part because it's nearly impossible for the company to employ experts who are knowledgeable about every region where the company has a presence. "It's hard to retain energy experts in-house," he said. "With aluminum, the physics don't change and the math stays the same. In power, it's all changing daily."

Hormel also outsources energy management. "You need to see what the market is doing, in all places around the country geographically, and that's not readily available without charge," Lutz said. "Partner with someone who has that core competency. Otherwise, you'll miss a lot of opportunities along the way."

Whether a company manages energy internally or with an external source, it's essential to have up-to-date market intelligence, said OSI's Brooks. "You need somebody taking the pulse on this as you would with whatever is important to your business," she said. "You have to have a complete understanding of what you're doing, why it makes sense to do one thing in Texas but not somewhere else."

Taylor from Wendy's/Arby's Group said purchasing managers can learn a lot about energy from talking to others in the industry. "We're all in the same boat," he said. "You can find out what's going on in that market without giving out the fry recipe." Taylor emphasized that it's important to stay current with pending legislation that could impact energy costs and to be involved with local utilities. "We try to be every utility's best customers, at least in our class," he said. "When an opportunity comes up, we want them to think of us first."

Bush with Iasta said market intelligence is essential for energy, while other commodities don't require such close monitoring. "No one is tracking indices for office supplies," he said.

4

NOT JUST AGGREGATION

The more you buy, the more you buy

With most commodities, it is assumed that the more you buy, the more leverage you have to negotiate a lower price. If you buy 50,000 boxes, you can expect to pay less than someone buying 500.

That's not always the case with energy. Because regulations and other factors vary from region to region, aggregating the buy does not always yield a more favorable price.

Taylor with Wendy's/Arby's Group is in charge of buying energy for 3,500 company-operated Wendy's and Arby's restaurants. He noted that restaurants have the most energy used per square foot of any commercial building. However, he has no price advantage over a local diner. "In a regulated state, it doesn't matter if you have one restaurant or a million and one. You get no credit for buying power," he said.

Unless your company buys a large amount of energy for a single location, or your energy for multiple sites is provided by a single utility, there is no price advantage for large energy buys. Even if multiple sites can aggregate their buy from a single supplier, they may get better rates by going it alone. For example, one site may reside within a business unit of the parent company and not secure credit terms as favorable as the other site. Many factors can drive contract preference, and all too often, procurement professionals too quickly assume that aggregating volume is the most effective tool in the shed.

In addition to the size of your load, the shape of your load can drastically impact pricing. The time of day when a facility requires the most energy and its pattern of use can significantly impact the site's utility rate, contract terms or price offerings.

"Cardboard doesn't change in price if it shows up at 2 in the afternoon or 2 in the morning," explained Andres of Owens Corning. "But 2 a.m. power costs less than 2 p.m. power."

MEASURES OF SUCCESS

Victory looks different

With most commodities, purchasing professionals are evaluated primarily on how well they reduce costs. Because energy costs vary for reasons far outside of anyone's control, unit or total cost reductions cannot be the only measures of success.

Verso's Poole said he often can point to money saved but his success often comes in the form of staying ahead of the market and taking action to avoid or mitigate a cost increase.
Lutz at Hormel said cost is only part of the issue. "We're geared toward low cost, but that's not the only thing. I'm evaluated on how well I keep track of it, knowing where and what we spent and what it's going to do so we can plan from an operations standpoint. There's much more value in planning."

Bush of Iasta said he looks for cost avoidance. "It's hard to pin down cost savings with energy," he said. "You look at what you would have paid if you hadn't acted versus what you did pay." Taylor, who was formerly in a similar position at a private national restaurant chain before coming to Wendy's/Arby's, said a public company places a high value on budget certainty. Locking in a favorable rate, even though prices may drop, enables the company to plan, minimize risk and meet street expectations. A private company may prefer to take a more aggressive approach and ride the market in hopes the price will go down.

APPLES & ORANGES ON YOUR PLATE

All the purchasing professionals interviewed said if you are managing your company's energy spend, it's essential to recognize how it differs from other commodities and accept that there can be a steep learning curve.

"A power manager once told me, it takes two years to learn how to spell kilowatt," said Andres of Owens Corning with a laugh. He said learning to use a simple kW symbol is the least of a new energy manager's challenges.

At Iasta, Bush urges clients to think long term. "With complex categories like energy, a managed approach can keep costs under control over a long period of time."

Poole at Verso said managing energy costs takes a concerted effort. "You have to treat it as a full-time business to do the best you can," he said. "If you make it your part-time business, you wouldn't do it as well. You have to be on your toes all the time."

THE SEEDS OF WISDOM

This independent white paper was commissioned by Summit Energy. As a leading global energy management company, Summit Energy has provided leadership and guidance to some of the world's best companies in the areas of strategic energy procurement, risk management and carbon emissions reporting and reduction. The information expressed in this document was provided by the professionals interviewed as well as the 300+ energy management professionals who comprise Summit's global workforce, serving hundreds of regional, national and global organizations. As an independent company, Summit Energy is an unbiased advocate for industrial and commercial energy end users. It exists to help companies mitigate the impact of rising and volatile costs associated with energy commodities and develop sustainable energy procurement and usage strategies.